

**N.D.A.G. Letter to Tomac (Nov. 12, 1985)**

November 12, 1985

Chairman  
Credit Review Board  
State Capitol  
Bismarck, ND 58505

Dear Mr. Tomac:

Thank you for your letter of September 27, 1985, in which you request an opinion in regard to the divestiture of foreclosed farmland. I apologize for the delay in responding.

I am assuming your request is really in two parts. First, you ask for the length of time a corporate lender whose acquisition of farmland would otherwise violate N.D.C.C. Ch. 10-06 has to divest that farmland pursuant to N.D.C.C. Ch. 10-06. Second, you ask whether or not corporate lenders, such as those federal instrumentalities formed pursuant to the Farm Credit Act, are subject to the divestiture requirements of N.D.C.C. Ch. 10-06. Accordingly, the response will be divided into two parts.

I.

N.D.C.C. 10-06-13, the enforcement section of North Dakota's corporate farming law, requires "[a]ll farm or ranchland acquired as security for indebtedness, in the collection of debts, or by the enforcement of a lien or claim" to be "disposed of within three years after acquiring ownership, if the acquisition would otherwise violate . . . [chapter 10-06]." Any corporation not disposing of the farmland or ranchland within the 3-year period would be subject to an action for violation of N.D.C.C. Ch. 10-06. If found to be in violation, the district court could order divestiture of the farm or ranchland within a time not to exceed one year from the date of the court's final order. Any corporation then failing to comply with the court's order must be dissolved by the Secretary of State. Any land not divested within the divestment period must be sold at public sale in the manner prescribed by law for the foreclosure of a real estate mortgage by action.

In 1985, the North Dakota Legislative Assembly passed House Bill No. 1636 which substantially amended N.D.C.C. 10-06-13, by adding new divestiture requirements. 1985 N.D. Sess. Laws 146. N.D.C.C. 10-06-13 currently reads, in part, as follows:

10-06-13. Enforcement.

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4. Subject to the divestiture requirements of subsections 5, 6, and 7, a domestic or foreign corporation may acquire farmland

or ranchland as security for indebtedness, by process of law in the collection of debts, or by any procedure for the enforcement of lien or claim thereon, whether created by mortgage or otherwise.

5. Unless retention of the farmland or ranchland is permitted under subsection 6 or 7, all farmland or ranchland acquired as security for indebtedness, in the collection of debts, or by the enforcement of a lien or claim shall be disposed of within three years after acquiring ownership, if the acquisition would otherwise violate this chapter.
6. The disposition requirement does not apply to a corporation that has acquired title to the land through the process of foreclosure of a mortgage, or a deed from a mortgagor instead of a foreclosure, if, by the expiration of one month after what is or what would have been if the mortgage had been foreclosed the redemption period of the mortgage, that corporation leases to the prior mortgagor from whom it was acquired, with an option to purchase, and if documents evidencing the lease agreement have been filed with the register of deeds of each county in which the land is located. A copy of a notice of lease is sufficient evidence. The exemption in this subsection applies for only five years and then only if the property has been appraised in accordance with subsection 8. The annual lease payments required of the tenant cannot exceed seven percent of the appraised value.
7. The disposition requirement does not apply to a corporation that has acquired title to the land through the process of foreclosure of a mortgage, or a deed from the mortgagor instead of foreclosure, if, by the expiration of one month after what is or what would have been if the mortgage had been foreclosed the redemption period of the mortgage, that corporation contracts for the sale of the land to the prior mortgagor from whom it was acquired, and if documents evidencing the purchase agreement have been filed with the register of deeds of each county in which the land is located. A copy of a notice of the contract for deed is sufficient evidence. An exemption under this subsection is valid only if an appraisal has been made in accordance with subsection 8, and if it is valid, the exemption is unlimited in duration. The sale price cannot exceed the price determined by the appraisers. (Emphasis supplied.)

The new language of N.D.C.C. 10-06-13 basically suspends the application of the 3-year period of divestment under certain conditions (Subsections 6 and 7 -- "The disposition requirement does not apply"). The retention of the farmland by the corporation is legalized by new subsections 6 and 7 of N.D.C.C. 10-06-13 (Subsection 5 -- "Unless retention of the farmland or ranchland is permitted under subsection 6 or 7") and the three year period of divestment does not begin to run, but is, in effect, suspended.

However, if the corporation ceases to lease the farmland to the prior mortgagor, or the five year exemption period runs and the prior mortgagor has not purchased the property, or if the prior mortgagor defaults on the contract for the sale of the land, the retention of the farmland or ranchland by the nonqualifying corporation is no longer permitted and the three year disposal period begins to run.

The logical conclusion is that, under the proper circumstances, the land need not be disposed of by a corporation for at least eight years (when the land is leased to the prior mortgagor). If the land has not been properly disposed of at the end of eight years, the Attorney General may bring an action against the corporation. In such a case the corporation may have up to another year to divest itself of the land after the court orders divestiture. Of course, a corporation may have considerably longer to divest itself of agricultural land in the situation where the prior mortgagor defaults on the contract for deed after a long period of time (e.g. 10 years) thereby reinstating the three year disposal requirement.

In any case, it may be a considerable length of time from the date the corporation first acquired the land, by means of foreclosure or otherwise, until it is actually required by law to divest. However, during the greater portion of that time, the operations on the farmland or ranchland will have actually been undertaken by the prior mortgagor.

## II.

Additionally, implicit in your request is the question of whether or not a corporate lender such as those federal instrumentalities formed pursuant to the Farm Credit Act of 1971, as amended, are subject to the requirements of N.D.C.C. Ch. 10-06; specifically, the divestiture requirements.

First of all, "[a]ll corporations, except as otherwise provided in this chapter, are prohibited from owning or leasing land used for farming or ranching and from engaging in the business of farming or ranching." N.D.C.C. 10-06-01. Therefore, all corporations, including all corporate lenders, are prohibited from owning or leasing farmland or ranchland. N.D.C.C. Ch. 10-06 specifically exempts only nonprofit corporations, family farm corporations, certain corporations using land for surface coal mining or industrial and business purposes, and certain cooperative corporations. Farm Credit Act institutions do not qualify for any of the exceptions.

N.D.C.C. 10-06-04 states as follows:

10-06-04. COOPERATIVE CORPORATIONS ALLOWED TO ENGAGE IN THE BUSINESS OF FARMING OR RANCHING --REQUIREMENTS. -- This chapter does not prohibit cooperative corporations, seventy-five percent of whose members or shareholders are actual farmers or ranchers residing on farms or ranches or depending principally on farming or ranching for their livelihood, from acquiring real estate and engaging in cooperative farming or ranching. (Emphasis supplied.)

This section does not exempt Federal Land Banks or their local associations, Federal Intermediate Credit Banks or PCA's, or Banks for Cooperatives from the provisions of N.D.C.C. Ch. 10-06, thereby allowing them to own land used for farming or ranching. Although these institutions are cooperative corporations which may consist of members or shareholders, at least seventy-five percent of whom are actual farmers or ranchers, they do not engage in cooperative farming or ranching. Rather, they are formed for and engaged in lending purposes. If they were directly engaged in cooperative farming or ranching, they would be exempt from the provisions of N.D.C.C. Ch. 10-06. Since they do not engage in cooperative farming or ranching, they are not exempt by means of N.D.C.C. 10-06-04.

The question which then arises is whether state law which requires divestiture, unless there exists a specific exemption or certain conditions are met, applies to these Farm Credit Act institutions. A correlative issue is whether it applies to noncorporate federal institutions, such as the Farmers Home Administration (FmHA).

In regard to the FmHA, it has been subject to state law for various purposes. See Johnson v. U.S. Department of Agriculture, 734 F.2d 774 (8th Cir. 1984); United States v. Chappell Livestock Auction, Inc., 523 F.2d 840 (8th Cir. 1975). However, FmHA is not a corporation, but a federal agency. Therefore, there is no prohibition on it holding farmland in North Dakota.

In contrast, the Farm Credit Act institutions are incorporated cooperatives, instrumentalities of the United States Government. These institutions are also subject to state law for various purposes. Over the years there have been many cases dealing with the federal law-state law issue which may apply to the question of applicability of state law.

In United State v. Kimbell Foods, Inc., 440 U.S. 715 (1979), a landmark case involving a Small Business Administration's security interest and a Farmers Home Administration security interest and the concerning priority of those security interests, the United States Supreme Court said that the priority of liens stemming from federal lending programs must be determined with reference to federal law. "This Court has consistently held that federal law governs questions involving the rights of the United States arising under nationwide federal programs." Id. at 726. However, the Court recognized that statutes authorizing the SBA and FmHA federal lending programs did not specify the appropriate

rule of decision. *Id.* at 727. Because a national rule is unnecessary to protect the federal interest underlying the SBA and the FmHA loan programs, the Court held that the relative priority of private and consensual liens arising from the programs is to be determined under nondiscriminatory state laws absent a Congressional directive to the contrary. *Id.* at 740. The analysis of the Court was as follows:

Whether to adopt state law or to fashion a nationwide federal rule is a matter of judicial policy "dependent upon a variety of considerations always relevant to the nature of the specific governmental interests and to the effects upon them of applying state law. . . ." Undoubtedly, federal programs that "by their nature are and must be uniform in character throughout the Nation" necessitate formulation of controlling federal rules. . . . Conversely, when there is little need for a nationally uniform body of law, state law may be incorporated as the federal rule of decision. Apart from considerations of uniformity, we must also determine whether application of state law would frustrate specific objectives of the federal programs. If so, we must fashion special rules solicitous of those federal interests. Finally, our choice of law inquiry must consider the extent to which application of a federal rule would disrupt commercial relationships predicated on state law. *Id.* at 728-729.

The Court went on to say that incorporating state law to determine the rights of the United States as against private creditors will in no way hinder administration of the SBA and FmHA loan programs. *Id.* at 729. In Kimbell Foods, the agency's own operating practices recognized that the government's security interests are controlled by the commercial law of each state and belied the assertion that a uniform rule of priority is needed to avoid the administrative burdens created by disparate state commercial rules. *Id.* at 732-732. Kimbell Foods stands for the proposition that state law can and should be the rule of a federal decision, barring frustration of federal objectives, until Congress strikes a different accommodation. See also Georgia Power Co. v. Sanders, 617 F.2d 1112, 1118 (8th Cir. 1980).

The case of Southern Pacific Transp. Co. v. United States, 462 F. Supp. 1193 (D.C. Cal. E.D. 1978), also specifically spelled out the law to be applied in federal courts:

The law to be applied in the federal court varies depending on the nature of the particular case and of the specific issues in the case. There are three general categories into which that law may be subdivided: (1) State law operative of its own force, (2) State law incorporated or adopted into federal law as the federal rule of decision, and (3) Federal law uniform throughout the nation. The selection of the appropriate law depends on the circumstances of each case, not on the nature of the court's jurisdiction or on other clear guide lines. For example, in the usual diversity jurisdiction case, state law will govern of its own force; the federal court sits, in effect, as another state court. . . .

Despite this general rule, state law will not apply of its own force in a diversity case when the particular issue is one of federal law. In such a case, the Constitution, federal statutes, federal regulations, and/or federal common law "otherwise require," and state law cannot apply of its own force. . . . The fact that federal law will govern in such instances does not necessarily indicate that the law will be a uniform federal rule throughout the nation. Instead, the federal rule of decision can derive from state law. In other words, once it has been determined that the matter is governed by federal law, there is a subsidiary question whether the content of that federal law is derived from an incorporation of state law as the federal rule of decision or is declared to be a uniform federal rule arising, for example, from a statutory or constitutional mandate. . . .

In still other instances, uniform federal rule governs. As noted by the Supreme Court in the reconstruction finance case, Congress usually intends that its statutes are to be uniformly applied throughout the nation. . . . In such circumstances, federal law provides the rule of decision, and that rule is not dependant on or derived by incorporation of state law. Uniform federal law is not restricted to constitutional or statutory law; federal common law rules may likewise be uniform throughout the nation or, conversely, be derived by incorporation of state law and varying depending on the applicable state law.

To summarize, a federal court may apply state law in a given cause or to a particular issue in a case either as operative of its own force or as incorporated into federal law, or the Court may apply uniform federal law. The selection of the appropriate law is not dependant on whether the jurisdictional basis for the action is diversity or federal question jurisdiction. In either instance, the controlling principles are found in the federal constitutional, statutory, and common law requirements. If these requirements mandate the application of federal law, then state law operating of its own force is inapplicable. Even in such a case, however, state law may provide the rule of decision if it is appropriate to adopt or incorporate state law into the federal law as to that issue. *Id.* at 1198-1200.

In a more recent case, the United States Court of Appeals for the Second Circuit, in United States v. Oswego Barge Corporation, 664 F.2d 327 (2d Cir. 1981), stated that when an entire subject is outside the scope of a federal statute, other liabilities and remedies concerning that subject remain in force unless the statute unmistakably evidences Congressional intention to alter them. *Id.* at 345. Federalism concerns create a presumption against preemption of state law, including state common law. *Id.* at 335; see also City of Milwaukee v. Illinois, 451 U.S. 304 (1981); Jones v. Raff Packing Company, 430 U.S. 519 (1977). Separation of power concerns create a presumption in favor of preemption of federal common law when it can be said that Congress has legislated on the subject. *Id.* at 335.

The case of Boyster v. Roden, 628 F.2d 1121 (8th Cir. 1980), was an interesting application of the Kimbell principles. The United States Court of Appeals said:

"The overriding federal interest requiring an application of federal common law in the cited cases is clear, but those decisions do not persuade us that there is a need to override state law with federal common law in respect to the obligations a Production Credit Association fiduciary owes to a loan applicant." *Id.* at 1124.

The Court went on to say:

In deciding whether rules of federal common law should be fashioned, normally the guiding principle is that a significant conflict between some federal policy or interest and the use of state law in the premises must first be specifically shown. It is by no means enough that, as we may assume, Congress could under the constitution really enact a complete code of law governing transactions in federal mineral leases among private parties. Whether latent federal power should be exercised to displace state law is primarily a decision for Congress. Even where there is related federal legislation in an area, as is true in this instance, it must be remembered that "Congress acts. . . against the background of the total corpus juris of the states. . . ." Hart and Wechsler, *The Federal Courts and The Federal System* 435 (1953). *Id.* at 1124-1125.

In another case, a United States District Court adopted the Illinois redemption law as the federal rule in an action by the United States to foreclose mortgages as security for a Small Business Administration loan. United States v. Marshall, 431 F. Supp. 888 (N.D. Ill., 1977). In this particular case although both the promissory note and mortgage given for the Small Business Administration loan provided that the signators waived all rights of redemption, the Court adopted the Illinois law that redemption rights cannot be waived in a security agreement on the basis that the interests of Illinois in protecting debtors' rights did not conflict with the federal policy underlying the Small Business Administration Act. It said allowing the right of redemption would encourage the policy of helping small businesses to survive. *Id.* at 891-92.

In another case, the Federal National Mortgage Association challenged a New York statute requiring mortgage-lending institutions to pay interest on tax and insurance escrow accounts. Federal National Mortgage Association v. Lefkowitz, 390 F. Supp. 1364 (S.D.N.Y. 1975). The Court noted that in certain circumstances, depending on Congressional authorization, a federal instrumentality may be subject to state law. The Court, citing Mayo v. United States, 319 U.S. 441 (1943), stated as follows:

"It lies within Congressional power to authorize regulation, including taxation, by the state of federal instrumentalities . . . There are matters of local concern within the scope of federal power which in the silence of Congress may be regulated in such manner as does not impair national uniformity. There are federal activities which in the absence of specific Congressional consent may be affected by state regulation." *Id.* at 1368.

The Federal District Court held that the statute did not impose a burden on the performance of the Federal National Mortgage Association's function so as to invalidate the federal statute. Id. at 1369.

Of course, in some cases it has been appropriate to preempt the field of state law. See Federal Land Bank of St. Louis v. Wilson, 533 F. Supp. 301 (E.D. Ark. 1981); Federal Land Bank v. Bismarck Lumber Co., 314 U.S. 95 (1941); Fidelity Federal Savings & Loan Association v. De La Cuesta, 458 U.S. 141 (1982); Contra, Federal Land Bank of St. Paul v. De Rochford, 287 N.W. 522 (N.D. 1939). Yet, Farm Credit Act institutions often times avail themselves of state law to protect their interests. See, e.g. Federal Land Bank of St. Paul v. State, 274 N.W.2d 580 (N.D. 1979); Federal Land Bank of St. Paul v. Koslofsky, 271 N.W. 907 (N.D. 1936).

There is nothing in North Dakota's corporate farming law, N.D.C.C. Ch. 10-06, particularly in its divestiture provisions found at N.D.C.C. 10-06-13, which would frustrate the federal objectives of the Farm Credit Act institutions. It would seem, then, that state law must be followed until Congress strikes a different accommodation.

Granted, federal law gives certain powers to the Federal Land Bank, the Federal Intermediate Credit Banks, and the PCA's as corporate bodies. It gives them the power to:

Acquire, hold, dispose, and otherwise exercise all the usual incidence of ownership of real and personal property necessary or convenient to its business. 12 U.S.C. 2012(5) (1980) (Federal Land Bank powers).

Exercise by its board of directors or authorized officers, employees, or agents all such incidental powers as may be necessary or expedient to carry on the business of the bank. 12 U.S.C. 2012(21) (1980). See also 12 U.S.C. 2072(5) and, (21) (Federal Intermediate Credit Bank powers); and 12 U.S.C. 2093(5) and (20) (Production Credit Association powers).

Nevertheless, a great deal of reliance is placed upon Farm Credit Act institutions operating and being treated just as ordinary citizens, or ordinary state and federal banks, with in each state. See 12 U.S.C. 2258. The Farm Credit Administration even uses state law for discretionary purposes. See 12 U.S.C. 2259. However, in this case, where only state law speaks to the issue of divestiture of farmland by corporations, and specifically corporate lenders (i.e. Farm Credit Act institutions), and when the purposes of the Farm Credit Act are in concert with divestiture (i.e. Farm Credit Act institutions are not in business to hold farmland), state law should govern in spite of the fact that Farm Credit Act institutions are created by and generally operated pursuant to federal law.

Sincerely,

Nicholas J. Spaeth